# Staying the Invisible Hand

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***Straight Talk on Trade: Ideas for a Sane World Economy***
by Dani Rodrik
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Martin Roemers/Panos Pictures

*A clothing market in Cairo, 2011; photograph by Martin Roemers from his book* Metropoli*, published by Hatje Cantz in 2015*

In 1997, when Dani Rodrik, a Turkish-born professor at Harvard's Kennedy School of Government, published his brief book *Has Globalization Gone Too Far?*, progressive economists widely embraced his arguments that many free trade policies adopted by the US, which reduced tariffs and other protections, also weakened the bargaining power of American workers, destabilized their wages, and encouraged social conflict. "The danger," Rodrik wrote presciently, "is that the domestic consensus in favor of open markets will ultimately erode to the point where a generalized resurgence of protectionism becomes a serious possibility." I remember that Robert Kuttner, the coeditor of *The American Prospect*, was particularly enthusiastic about the book. Almost twenty years later, he again praised Rodrik for his continued devotion to an empirically grounded skepticism of what Rodrik now calls "hyperglobalization."

*Has Globalization Gone Too Far?* challenged a mainstream economic belief that in 1997 was accepted with increasing fervor: that reducing tariffs to encourage trade almost always resulted in a healthier, more rapidly growing economy for all nations. If some workers in industries that directly competed with rising imports lost their jobs or had their wages reduced, it was assumed that the economy would create enough new jobs to compensate.

Free trade had been a principle of modern economic theory since Adam Smith. But an especially intense allegiance to it had grown out of the American drift toward laissez-faire economics that began in the 1970s with Milton Friedman, who advocated minimal government and the deregulation of markets. Best sellers like *The End of History and The Last Man* (1992) by the philosopher Francis Fukuyama and *The Lexus and the Olive Tree* (1999) by the journalist Thomas Friedman insisted that a reduction in protectionism and the development of free markets across the world would lead to prosperity and greater income equality. In 1991, Lawrence Summers told a reporter that in economics "one set of laws works everywhere"—that is, the benefits of free trade applied to all markets, big and small.

Rodrik is no proponent of Donald Trump's recently imposed tariffs, however. He thinks we need a balanced new trade policy, and for him Trump's bravado has no place in formulating one. We can reduce income inequality and retain the benefits of free trade with intelligent negotiation among nations, he argues, not grandstanding. Among other things, a new policy should include substantial funding and training for those in the US who lose jobs. One of Rodrik's most important points is that the nation needs a generous safety net if free trade policies are to succeed.

Paul Samuelson, the Nobel Prize–winning adviser to John F. Kennedy and Lyndon B. Johnson, wrote that the theory of comparative advantage, the theoretical foundation of free trade, was the one tenet in economics that was both nontrivial and incontrovertible. According to this theory, developed by the early-nineteenth-century British economist David Ricardo, even if Country A makes everything more efficiently than Country B—that is, produces more with less labor—both countries would benefit because Country B would also enjoy relatively lower prices on the goods made by Country A. The beauty of Ricardian free trade, as Samuelson described it, is that it should generate prosperity for most countries. Gains for the nation should exceed the combined losses of individual industries and workers.

During the 1990s, major new trade pacts reflecting the intense faith in free markets went into effect. In 1993 Bill Clinton, with overwhelming Republican and some Democratic support, signed the North American Free Trade Agreement (NAFTA), which established a free trade bloc among Mexico, Canada, and the US. In 1995, the General Agreement on Tariffs and Trade (GATT), which had overseen a broad reduction in tariffs for most of the prosperous post–World War II era, was replaced by the World Trade Organization, which imposed tighter and more strictly enforced rules that gave nations less flexibility than they had enjoyed under GATT to pursue government subsidies and other policies that would benefit their own economies.

The intensifying dedication to the free trade principle also led Clinton's economic team, under Lawrence Summers, to recommend that governments remove various caps and taxes on foreign investment. These regulations had been in place to restrict capital flows to poorer developing economies like South Korea and Malaysia. Without such restrictions, American financiers and corporations were free to chase higher interest rates, weaker financial regulations, and lower tax rates.

Under GATT, prosperity abounded in North America, Western Europe, and Japan. But Rodrik believes the new trade agreements under the WTO were too limiting, especially for developing nations. In his view, many economists had become ideologues, twisting empirical analyses to fit their theories. Rodrik wrote in a blog post last year about the "wildly optimistic" forecasts that respected economists had given for the benefits of NAFTA, including the number of jobs it would create.[*] The economists at the Institute for International Economics, which had published Rodrik's 1997 book in an attempt to balance professional discussion on globalization, ironically produced one of the most optimistic of these inflated forecasts. Clinton established a campaign led by William Daley, the Chicago politician and son of former mayor Richard Daley, to promote NAFTA. In 1993, on *Larry King Live*, Vice President Al Gore had come off well in a debate with the anti-NAFTA firebrand Ross Perot, whose exaggerations only added credence to Gore's arguments in support of the agreement.

Free trade advocates at Harvard and elsewhere did not all take warmly to *Has Globalization Gone Too Far?*, though Rodrik worked down the hall or across Harvard Yard from many of them. Brad DeLong, a Harvard professor and frequent coauthor with Summers, damned it with faint praise in a review when it came out. He suggested that Rodrik was simply repeating many of the criticisms that Karl Polanyi had made in his 1944 classic, *The Great Transformation*. Rodrik and Polanyi both thought that government intervention was critical to the development of Western economies. But de Long, who agreed with this broad thesis, mostly ignored Rodrik's new evidence that many workers, especially the less educated, were put at a disadvantage as the flow of trade and capital loosened. Rodrik's work did not initially change many minds, as many economists continued to maintain that "skill-biased" technological change, which favored workers with a college degree, was far more responsible for growing income inequality than were trade policies. They had arrived at that conclusion in part because trade then accounted for too little of the US economy to seem to matter much.

The Asian financial crisis of 1997 was one of the first signs that Rodrik's skepticism about free trade ideology had been justified. Asian economies collapsed when investors pulled out their "footloose capital," Rodrik's term for foreign funds withdrawn at the first sign of financial trouble or a better opportunity. Mainstream international economic institutions, such as the World Bank and the International Monetary Fund, imposed destructive austerity policies on these nations in an attempt to reinvigorate free market forces. What became known as the Washington Consensus—a series of policy recommendations from the US government that encouraged developing nations to practice fiscal discipline—made matters worse. They needed to pump up demand, not contract it with budget cuts.

Today Rodrik's 1997 views are increasingly accepted as conventional wisdom. He and others still recognize that skill-biased technological change contributes to income inequality, but a growing amount of evidence shows that trade, too, harms many workers and that the resulting social and political conflict can lead to a weaker social safety net. Donald Trump gained popular support by criticizing free-trade policies, including the twelve-nation Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (T-TIP), a proposed broad agreement between the US and the European Union. Bernie Sanders put criticism of free trade at the center of his presidential campaign. Hillary Clinton originally supported the TPP, but said in a 2015 debate with Sanders that "it didn't meet my standards."

Since *Has Globalization Gone Too Far?* appeared, Rodrik has published six more books reiterating and updating his arguments. The most recent of these, *Straight Talk on Trade: Ideas for a Sane World Economy*, arrives at a time of controversy. Trump has pulled out of the TPP (the other eleven participants in the negotiations have signed it) and is trying to negotiate changes to NAFTA with Mexico and Canada. Trump recently suggested that he might want to rejoin the TPP, then reverted to his previous position. In March, he threatened to impose tariffs on steel and aluminum imports from all nations, even those that don't dump their product—that is, sell it below cost—though he backed off the threat to some nations other than China. As of this writing, he is promising to roll out tariffs on more Chinese goods and China in turn promises to retaliate with new tariffs on American goods.

Rodrik is not confrontational. In both *Has Globalization Gone Too Far?* and *Straight Talk on Trade*, he sometimes bends over backward to avoid leveling harsh charges against apparent offenders of economic good sense. His gentle treatment of Eugene Fama, who justifiably won a Nobel Prize for his early work but later adamantly defended the rationality of the stock market, is an example perhaps of his bending too far. Such free market arguments, Rodrik writes elsewhere, were used to deregulate financial institutions broadly and thus were in part responsible for causing the 2008 crisis.

Recent studies that Rodrik cites in his new book provide further evidence for his earlier claims about the damage free trade can cause. In 2015, perhaps the most comprehensive mainstream study of NAFTA's benefits over more than twenty years showed that it was responsible for only a trivial increase in US economic growth—0.08 percent. Meanwhile, imports to the US from Mexico have doubled, enabling it, according to one thorough study, to enjoy far larger gains in GDP per capita from NAFTA than does the US. For those who remember the contempt that economists in the Clinton administration showed toward opponents of NAFTA, this must come as a surprise.

Even more surprising is a 2016 study that found that wage growth had been reduced by 17 percentage points in markets whose industries were most affected by NAFTA's cuts in tariffs. Wages were also depressed in companies from the same geographical areas as those that were directly affected by the resulting Mexican trade, even if they didn't lose business to Mexico directly. The two trade economists who conducted the study, John McLaren and Shushanik Hakobyan, found that less educated workers were most affected, since job loss typically occurred in lower-skilled manufacturing industries and services. More traditionally progressive economists, like Josh Bivens of the Economic Policy Institute, have found even more widespread wage losses from trade in general.

Phyllis Galembo/Steven Kasher Gallery, New York

*'Trump Mask,' Mexico, 2016; photograph by Phyllis Galembo*

The rapid growth of imports from China since it joined the WTO in 2001 and gained access to the markets of rich nations had a similar effect on wages. The MIT economist David Autor was originally among those who vehemently attributed income inequality in America largely to educational inequality in a time of growing technological innovation. But in 2016, Autor published a study with David Dorn and Gordon Hanson showing that Chinese exports depressed wages and caused unemployment to rise in many parts of America. This wage decline was not offset by job creation in other industries, as mainstream economists like Peter Petri and Michael Plummer—whose model of the TPP's effects had found benefits for all nations—had incorrectly predicted. "We should not act," Rodrik writes, "as if our cherished standard model has not been severely tarnished by reality."

Rodrik believes that some economists were again irresponsible in backing President Obama's advocacy of the Trans-Pacific Partnership. The widely distributed study by Petri and Plummer concluded that the TPP would cause a modest gain in US GDP, some increase in wages, and, the researchers proudly claimed, no job losses at all. But Rodrik points out—and I detect some anger in his otherwise mild-mannered writing here—that the study had built into its forecasting model an assumption that unemployment would not rise. This sort of tautological assumption is common, even required, in such models. A study that loosened its premises found that the TPP could indeed cause severe job losses.

Rodrik's concern over new trade deals goes well beyond the negative effects of free trade itself. The TPP, he writes, was a case of "corporate capture." It was designed both to increase pressure on China to adopt free trade policies and to counter that giant nation's growing economic power. If it had been ratified, however, it would have protected the intellectual property and regulatory rights of American big business, notably banks, drug companies, and technology companies. Meanwhile, by tightening restrictions on the sorts of trade policies countries could adopt, it would put developing economies at a significant disadvantage.

Nations that developed after World War II, such as Japan, South Korea, China, and Taiwan, Rodrik argues, did well when sizable American trade barriers were still in effect and capital flows were controlled by such measures as "subsidies, domestic-content requirements, investment regulations, and, yes, often import barriers," all of which "were critical to the creation of new, higher-value industries" in, for example, China and Vietnam. "There is nothing in the historical record," he insists, "to suggest that poor countries require very low or zero barriers in the advanced economies in order to benefit greatly from globalization." On the contrary: "Countries that rely on free trade alone (Mexico comes immediately to mind) have languished." Mexico benefited from trade, says Rodrik, but didn't invest domestically in industries that would improve its productivity and broadly raise wages.

Under the TPP, developing countries would be forced to depend on something closer to free trade alone. The policies on which China and Vietnam relied as their economies grew in the 1980s and 1990s, according to Rodrik, "violate current trade rules," which would have restricted the protective measures they could use. Vietnam, for instance, "would have had some assurance of continued access to the US market (existing barriers on the US side are already quite low), but in return would have had to submit to restrictions on subsidies, patent rules, and investment regulations." China, under similar rules, "would not have been able to pursue its phenomenally successful industrialization strategy."

Rodrik is equally concerned about the Transatlantic Trade and Investment Partnership, which would have some of the same limitations. In his 1997 book, he predicted that "the most serious challenge for the world economy in the years ahead lies in…ensuring that international economic integration does not contribute to domestic social *dis*integration." He doesn't say enough in *Straight Talk on Trade* about how specifically this is to be achieved, but he does offer some guidelines worth following. His most important suggestion, I'd argue, is to write new agreements that leave space for individual nations to adopt the policies they believe they need, which are now often limited by WTO rules. These could include labor policies such as minimum wages and paid family leave, business subsidies, and trade protections for some companies and industries, as well as environmental protections and strong financial regulations.

A major concern for developing nations, for example, is that start-up industries face competition from enormous international corporations that benefit from economies of scale—the more they sell, the lower their cost per unit. Tax breaks and subsidized government loans have supported the development of many industries, from steel to high technology, across East Asia and China. Agreements that put too many restrictions on the trade policies their members can adopt could limit the ability of governments to give their industries this sort of economic support.

Such industrial policies may also make sense in America, where—as Louis Uchitelle notes in his recent book *Making It: Why Manufacturing Still Matters* (2017)—there are social benefits to strengthening the manufacturing sector. For a long time, the growth of manufacturing created good jobs for black workers in central cities among others. That is no longer the case, and policies that encourage the creation of manufacturing jobs can be vital for these and other poor workers. There are also economic benefits. Supportive government policies could help provide smaller manufacturers with cheap capital, technical aid, and an affordable pool of qualified workers.

One of Rodrik's more provocative suggestions is to broaden the definition of "dumping." The WTO has a much-used procedure by which corporations can challenge the pricing of exports if they are being sold below production costs—indeed, this is one of the reasons the WTO was formed. But Rodrik thinks that other kinds of policies, such as those that prevent workers from organizing, are also a form of dumping, designed to keep costs down relative to other nations. There should be a mechanism at the WTO, he proposes, to challenge such "social dumping."

Rodrik believes strongly that trade discussions should be public and transparent. That the negotiations over the TPP were held in secret is perhaps the best demonstration of the arrogant confidence of free trade enthusiasts and their inordinate fear of criticism. It also raises the question of corporate influence, which is harder to track when negotiations are conducted out of the public view. The TPP's supporters, Rodrik argues, "only discredited themselves by deriding the skeptics as protectionists. Open, informed debate about specific provisions is exactly what was called for."

Rodrik is not uniformly progressive. He is opposed, for example, to increases in minimum wages well above those required by current laws. But he is deeply concerned about the misleading advice that some economists—like some of those at the Institute for International Economics—have given policymakers. The wide support among free market economists for ending capital controls in the late 1990s was a disturbing example of ideological group-think—a term that Rodrik does not use but that I believe is appropriate. Another, more current example is the Republican effort to roll back some of the banking rules enacted by the Dodd–Frank Wall Street Reform and Consumer Protection Act after the 2008 financial crisis. Some—though certainly no longer all—mainstream economists still justify the rollback using the same argument that led to inadequate regulations before the crisis: that efficient markets will regulate themselves, minimizing excesses through competition. This is the kind of theory that likewise assumes that workers in free labor markets are paid what they deserve and have no need for unions to bargain on their behalf.

Rodrik also admits he is disturbed about what some economists are teaching their students:

> In their zeal to display the profession's crown jewels in untarnished form—market efficiency, the invisible hand, comparative advantage—economists skip over the real-world complications and nuances. It is as if introductory physics courses assumed a world without gravity, because everything becomes so much simpler that way. Downplaying the diversity of intellectual frameworks within their own discipline does not make economists better analysts of the real world. Nor does it make them more popular.

I'd add to that list of "crown jewels" the belief that skill-biased technology is by far the most significant cause of income inequality, which remains prevalent among many economists even now that we have evidence for the effects of trade on income and employment.

Rodrik believes that a robust social safety net and a reinforced sense of community are what today's economy most urgently needs—the opposite of the recent policies of Trump and the Republicans. They would also enable the nation to support the more beneficial free trade policies even when they do occasional damage. The neglected former manufacturing workers of America's industrial heartland in Ohio, Wisconsin, and Pennsylvania surely helped elect Trump. Manufacturing jobs were already in rapid decline due to technological advances and outsourcing, but this trend might have been slowed by policies supporting newer technologies and better-managed manufacturing companies and assuring more aid and training for workers who lost their jobs as a result of international competition. America does provide some assistance to such workers, but it is minimal by comparison with many other developed countries.

The protectionist tariffs on Chinese goods that Trump has ordered are inspiring destructive countermeasures from China. They are also sending a misleading message that a solution is in the works for those voters in the industrial heartland who have lost their jobs. Rodrik opposes such blunt protectionism. Yet he does not say whether he thinks subsidies for American manufacturing industries might at least slow job losses and allow us to pursue more innovative technologies. In my view, they seem worth a try.

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* "What Did NAFTA Really Do?," January 26, 2017; available at rodrik.typepad.com. ↩